

Ireland's Not Greece; Markets Are Calmer, Waiting for U.S. States

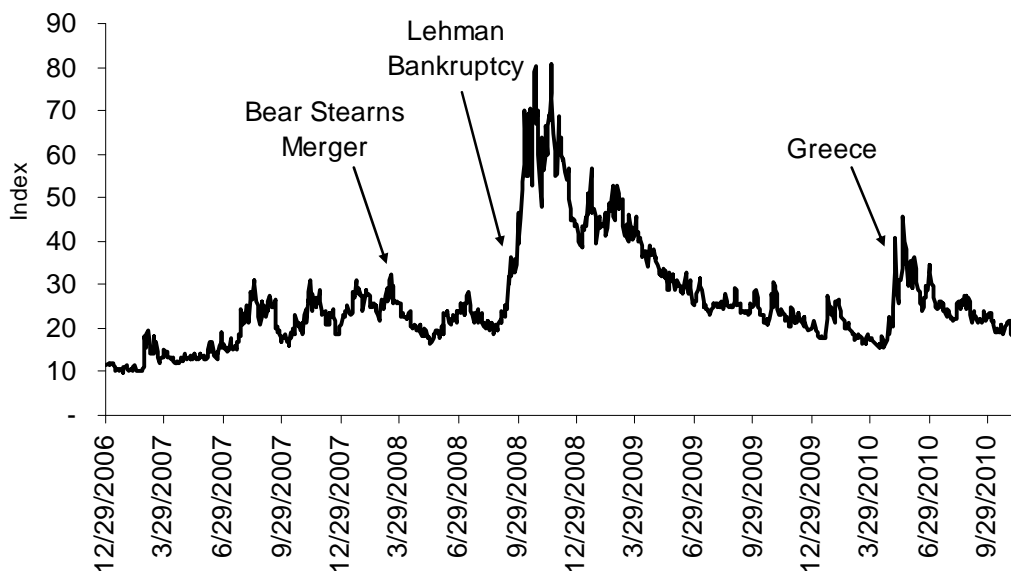
While Ireland's debt situation is a serious problem, we don't think it will, by itself, cause the global soft patch that coincided with Greece's crisis in the first half.

- We expect U.S. real GDP growth above 3% annualized in the fourth quarter. Today's Q3 data showed GDP grew 2.5% (revised up from 2.0% and well ahead of Q2's 1.7%). Third quarter consumption grew 2.8% (was 2.6% and 2.2% in Q2). We think the employment situation is the key variable in consumption growth, overshadowing the wealth effect and improving gradually in the fourth quarter. We expect China to slow some in 2011 but to continue its rapid shift toward internal growth.
- However, we remain cautious near-term based on the risk of a severe year-end tax increase and disappointment over the Fed's quantitative easing (there's no monetary stimulus for the job-creating parts of the economy or throughput to bank lending).

Markets are not showing as dramatic a response to Ireland as they did to Greece.

- The Vix volatility index is calmer. In the Greek crisis, it surged to 40 from 17. There's been no reaction to the Irish crisis.

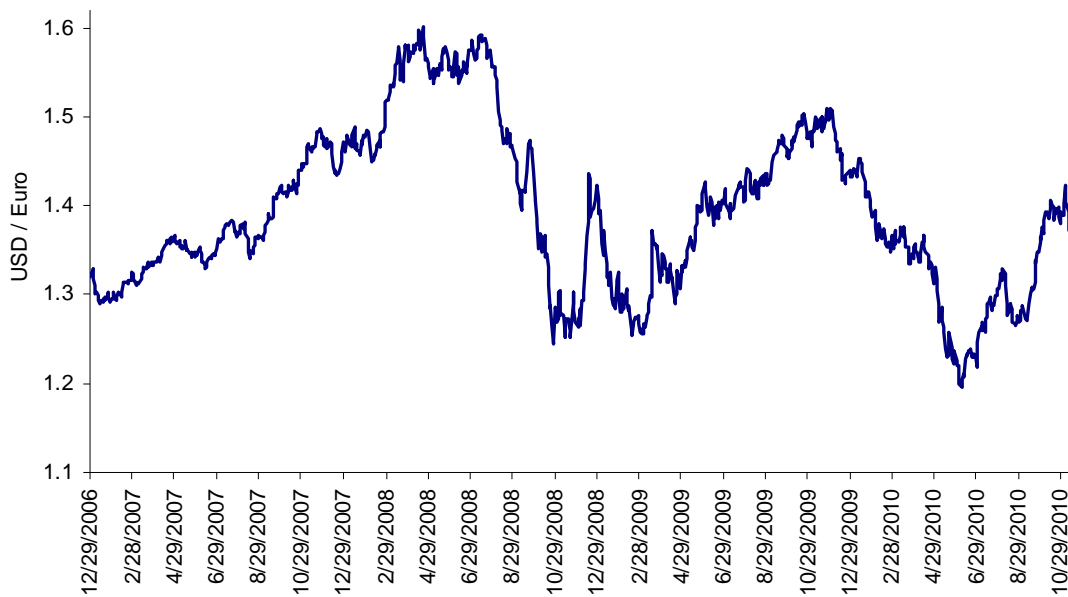
VIX – Volatility Index (last obs. November 23, 2010)



Source: Bloomberg; Encima Global

- The euro has weakened to \$1.34 from \$1.40, but not nearly as much as it did with Greece's bailout (to \$1.20 from \$1.35 or higher).

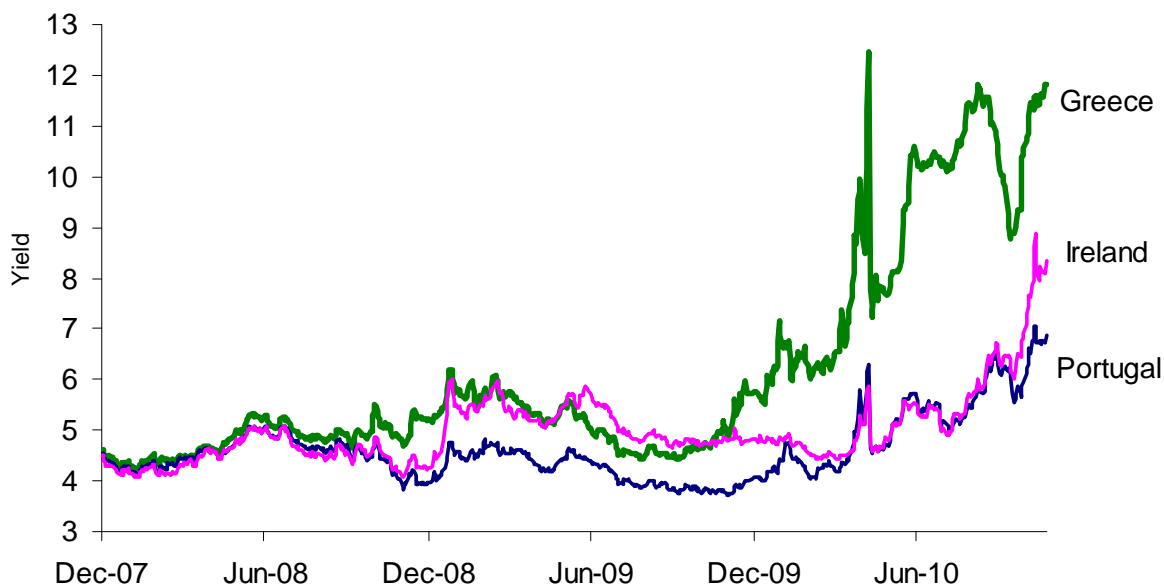
USD / Euro (last obs. November 23, 2010)



Source: Bloomberg; Encima Global

- Irish bond yields have risen sharply to 8.4% for the 10-year, but not to Greek levels, which remain at 11.8%.

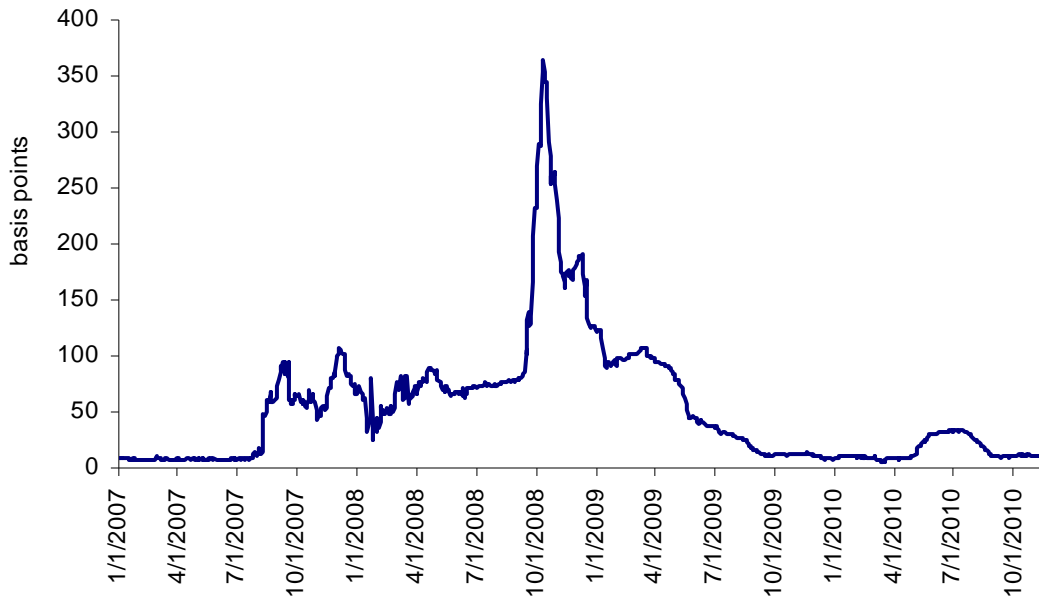
Selected European Yields (last obs. November 23, 2010)



Source: Bloomberg; Encima Global

- There's been no upturn in short-term interbank spreads, a contrast with the reaction to Greece. The Libor-OIS spread (a sophisticated Ted spread using the Overnight Indexed Swap market rather than Treasury bills) has been flat, having widened during each of the other crises since 2007 including the Greek crisis.

Libor minus OIS (last obs. November 23, 2010)



Source: Bloomberg; Encima Global

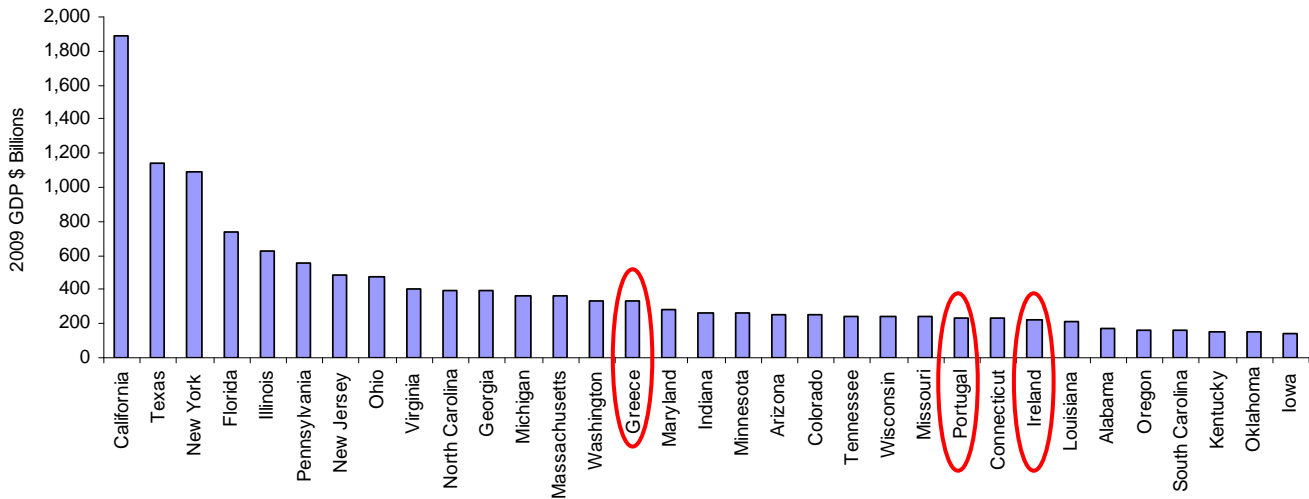
Expect Rolling Debt Crisis in U.S. States

Our November 10 piece explained key differences since the Greek crisis.

- Briefly, there's less talk of a euro-zone breakup (which would be catastrophic); there's a full-fledged ECB/EU/IMF bailout mechanism and funding; and German banks are less exposed.
- In addition, Ireland's structural conditions (medium-term national profitability) are much better than Greece's. Ireland's problem is more a legacy cost from bad loans by its banks, whereas Greece's problems relate to both debt and ongoing fiscal deficits. Ireland's outlook depends on the terms for the new loan (will it be long enough for Ireland to grow and pay) whereas Greece's outlook depends on its political ability to cut government workers, their pensions and other government spending enough to avoid a debt restructuring (doubtful, in our view).
- We expect U.S. states and many cities to get caught up in the rolling debt problems sweeping Europe. Like Greece, the issue will be whether governments can orchestrate deep spending cuts in time to avoid debt restructurings.

- In terms of GDP, Greece, Ireland and Portugal are small compared to many U.S. states.

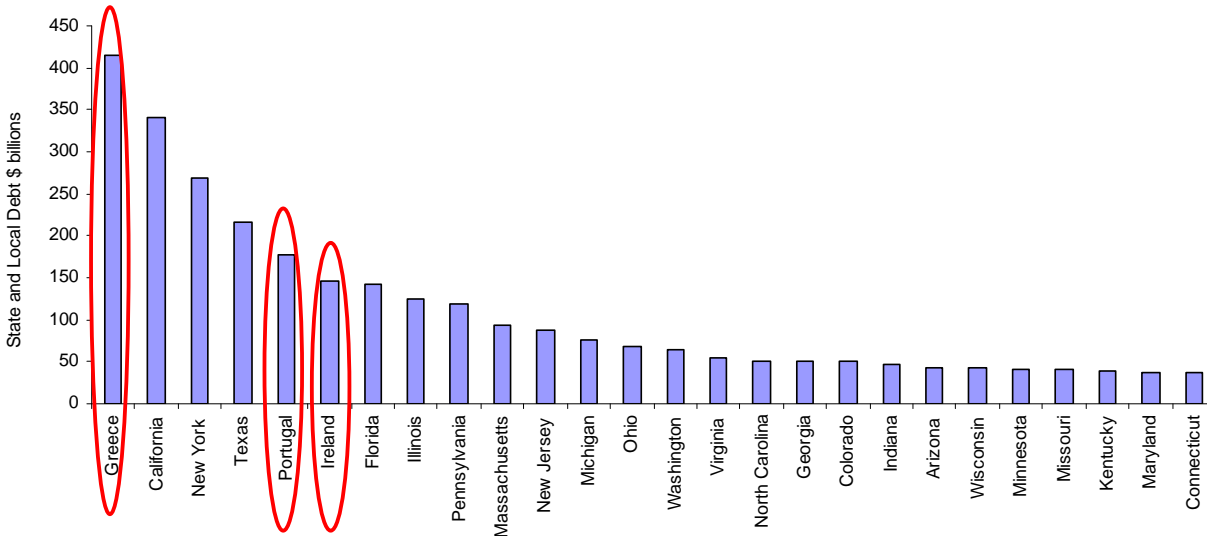
GDP in USD: Greece, Ireland, Portugal and Largest States



Source: BEA; IMF; Encima Global

- In terms of debt, Greece, Ireland and Portugal are large compared to U.S. states. For example, Greece's 2009 debt was \$414 billion compared to \$270 billion for New York state. However, the European sovereign debts are small compared to the U.S. federal government, the world's top debtor at \$8.5 trillion in marketable Treasuries (of which the Fed owns over \$800 billion and plans to buy another \$600 billion.)

Debt in USD: Greece, Ireland, Portugal and Largest States

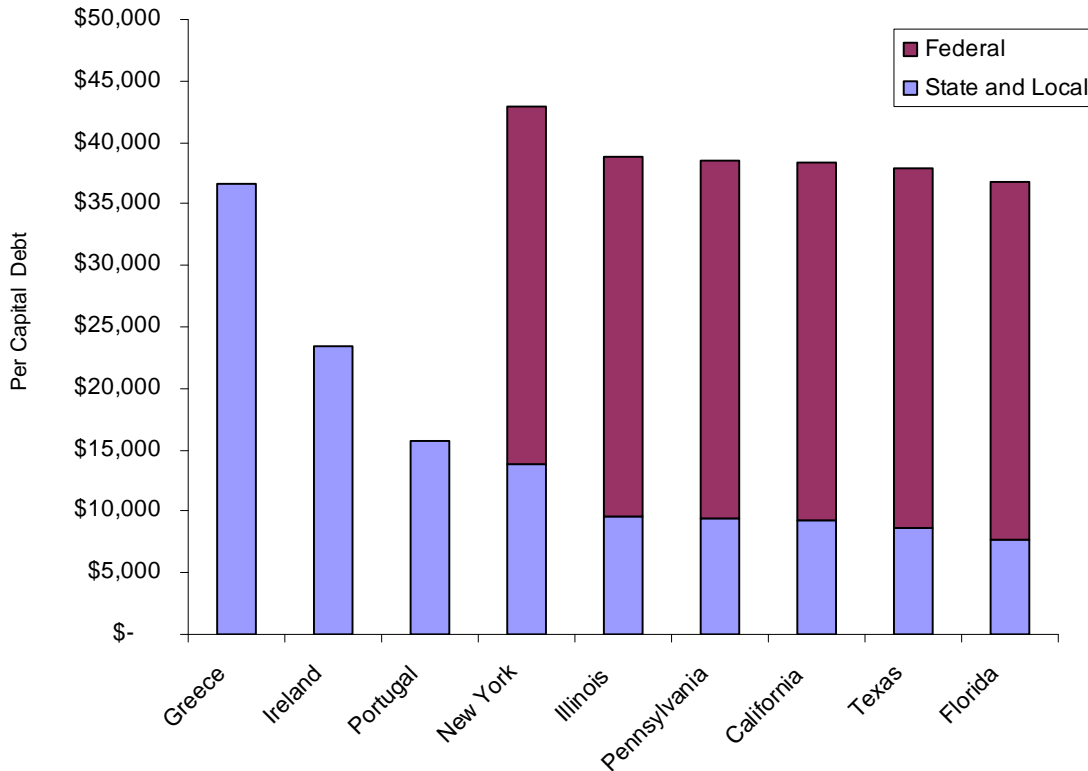


Source: Census Bureau; IMF; Encima Global

- In terms of per capita debt, Greece, Ireland and Portugal are large debtors compared to U.S. states. However, U.S. federal debt is roughly \$29,000 per capita on top of the

state and local debt shown in the bar graph. Combining federal, state and local debt, the U.S. per capita debt burden averages \$37,000 nationwide, ranging from \$43,000 for states like New York to a little under \$33,000 each for Idaho and Wyoming.

Per Capita Debt: Greece, Ireland, Portugal and Largest States



Source: Census Bureau; IMF; Encima Global

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